

Message Text

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TO SECSTATE WASHDC PRIORITY 1979

UNCLAS SECTION 1 OF 2 OTTAWA 5010

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TAGS: ECON, EFIN, EINV, CA
SUBJ: CONFERENCE BOARD IN CANADA 1977 ECONOMIC FORECAST

REF: OTTAWA 3785

1. SUMMARY: ACCORDING TO LATEST FORECAST RELEASED
DECEMBER 20 BY CONFERENCE BOARD, CANADA'S ECONOMIC
GROWTH WILL SLOW MARKEDLY IN 1977. REAL GNP WILL
EXPAND ONLY THREE PERCENT COMPARED WITH ALMOST FIVE
PERCENT EXPANSION IN 1976. THIS IS PESSIMISTIC REVISION
OF BOARD'S 4.7 PERCENT 1977 GROWTH FORECAST MADE IN
SEPTEMBER. WEAKENED GROWTH WILL PRODUCT AN AVERAGE
7.9 PERCENT UNEMPLOYMENT RATE COMPARED TO 7.2 PERCENT
RATE THIS YEAR. CONSUMER PRICE INDEX WILL DROP ONLY
Marginally FROM 7.6 PERCENT TO 7.3 PERCENT. BOARD
ATTRIBUTES GLOOMY FORECAST TO: (1) DOWNWARD REVISION OF
CAPITAL SPENDING ESTIMATES WHICH IS IN TURN DUE TO
HIGH LEVEL OF EXCESS CAPACITY, FURTHER DECLINES IN
CORPORATE PROFIT, LACK OF BUSINESS SUPPORT FOR GOC
ECONOMIC POLICY, AND CONTINUING RISE IN PRODUCTION
COSTS; (2) \$1 BILLION INCREASE IN SERVICES DEFICIT
TO \$6.9 BILLION WHICH WILL BE PARTLY
OFFSET BY AN IMPROVED TRADE BALANCE RESULTING IN A
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CURRENT ACCOUNT DEFICIT OF \$3.9 BILLION IN 1977
COMPARED TO \$4.1 BILLION IN 1976; AND (3) DOWNWARD
REVISION OF SEPTEMBER GOVERNMENT SPENDING ESTIMATE.
THESE FACTORS WILL REDUCE PERSONAL INCOME GROWTH
RATE FROM 6.9 PERCENT TO 3.3 PERCENT. ALTHOUGH
CONSUMER SPENDING IS ESTIMATED TO BE ONE OF THE

STRONGER ELEMENTS IN THE ECONOMY, IT WILL NONETHELESS EXPAND ONLY 3.5 PERCENT IN 1977 COMPARED TO SIX PERCENT THIS YEAR. FURTHER EMBASSY COMMENT FOLLOWS BY SEPTTEL. END SUMMARY.

2. FOLLOWING IS TEXT, LESS TABULAR DATA WHICH EMBASSY WILL FORWARD BY AIRGRAM, OF CONFERENCE BOARD NEWS RELEASE ON THE FORECAST:

BEGIN TEXT:

OTTAWA, DEC 20 ... THE PACE OF ECONOMIC ACTIVITY IN CANADA IN 1977 WILL EXPERIENCE A SUBSTANTIAL SLOWDOWN ACCORDING TO THE LATEST QUARTERLY CANADIAN FORECAST OF THE CONFERENCE BOARD IN CANADA. THE DETERIORATION IN THE OUTLOOK FOR 1977 IS THE RESULT OF THE UNANTICIPATED CONTINUING WEAKNESS OF THE ECONOMIC RECOVERY IN THE MAJOR COUNTRIES OF THE INDUSTRIALIZED WORLD AND THE IMPACT OF INCREASED UNCERTAINTIES ON BUSINESS CAPITAL SPENDING IN THE DOMESTIC ECONOMY. WHILE REAL G.N.P. IS STILL EXPECTED TO INCREASE BY CLOSE TO 5 PERCENT IN 1976, IT NOW APPEARS THAT ECONOMIC GROWTH WILL BE A MODEST 3 PERCENT IN 1977. THE OUTLOOK FOR GROWTH IN REAL FINAL DOMESTIC DEMAND IS EVEN MORE INDICATIVE OF THE UNDERLYING WEAKNESS IN THE ECONOMY. REAL FINAL DOMESTIC DEMAND IS EXPECTED TO INCREASE BY ONLY 2 1/2 PERCENT IN 1977 FOLLOWING AN INCREASE OF 4 1/2 PERCENT IN 1976.

AS A RESULT OF THE WEAKER OUTLOOK FOR OUTPUT GROWTH,
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EMPLOYMENT GAINS ARE EXPECTED TO BE MODEST IN 1977 AND UNEMPLOYMENT IS LIKELY TO INCREASE. FOR 1977 AS A WHOLE, THE UNEMPLOYMENT RATE WILL AVERAGE 7.9 PERCENT, AN INCREASE FROM ITS AVERAGE LEVEL OF 7.2 PERCENT IN 1976.

IT SHOULD BE UNDERLINED THAT THIS FORECAST, AS OTHER FORECASTS PUBLISHED BY THE CONFERENCE BOARD IN CANADA, ASSUMES NO CHANGE IN GOVERNMENT ECONOMIC POLICIES OTHER THAN THOSE ALREADY ANNOUNCED. MORE SPECIFICALLY, THE PROGRAM OF WAGE AND PRICE CONTROLS IS ASSUMED TO REMAIN IN FORCE THROUGHOUT THE FORECAST PERIOD, MONETARY POLICY TO REMAIN UNCHANGED, AND THE CURRENT FISCAL STANCE TO VARY ONLY AS A RESULT OF THE IMPACT OF THE PACE OF ECONOMIC ACTIVITY ON THE AUTOMATIC STABILIZERS.

IN RELEASING THIS FORECAST, ROBERT R. DE COTRET, PRESIDENT OF THE CONFERENCE BOARD IN CANADA, STATED "THE

WEAKNESSES NOW EVIDENT IN THE OUTLOOK FOR 1977 ARE PARTICULARLY WORRISOME IN VIEW OF THE EXISTING HIGH LEVEL OF EXCESS CAPACITY. THE CHALLENGE NOW BEFORE US IS CLEARLY TO AVOID AN ABORTION OF THE CURRENT ECONOMIC RECOVERY SUCH AS OCCURED IN THE EARLY 1960'S"

THE PRINCIPAL FACTORS ACCOUNTING FOR THE DOWNWARD REVISION IN THE FORECAST OF ECONOMIC GROWTH IN 1977 FROM THAT PREPARED IN SEPTEMBER ARE A MORE PESSIMISTIC VIEW OF THE PROSPECTS FOR INVESTMENT SPENDING IN CANADA AND A LESS BUOYANT OUTLOOK FOR GROWTH IN THE ECONOMIES OF CANADA'S TRADING PARTNERS, IN PARTICULAR, THE UNITED STATES. WHILE IT HAS BEEN EXPECTED FOR SOME TIME THAT BUSINESS SPENDING ON PLANT AND EQUIPMENT WOULD BE WEAK IN 1977, IT NOW APPEARS THAT PREVIOUS FORECASTS OF THESE EXPENDITURES HAVE BEEN OVERLY OPTIMISTIC. A CONTINUING HIGH DEGREE OF EXCESS CAPACITY, FURTHER DECLINES IN CORPORATE PROFITS, AN ECONOMIC POLICY ENVIRONMENT THAT DOES NOT HAVE

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THE SUPPORT OF THE BUSINESS COMMUNITY, CONTINUING RAPID ESCALATIONS IN PRODUCTION COSTS AND IN THE PRICES OF CAPITAL GOODS IN CANADA AND THE INCREASED UNCERTAINTIES CAUSED BY THE CONTINUING WEAKNESS IN EXPORT MARKETS, BY THE WIDE RANGING DEBATE ON THE DE-CONTROL SCENARIO AND THE POST-CONTROLS ENVIRONMENT AND BY THE ELECTION RESULTS IN QUEBEC, HAVE COMBINED TO CREATE A CLIMATE WHICH IS LIKELY TO HAVE A HIGHLY DISCOURAGING IMPACT ON BUSINESS INVESTMENT PLANS. ON THE BASIS OF THESE CONSIDERATIONS IT IS NOW ANTICIPATED THAT BUSINESS INVESTMENT SPENDING ON PLANT AND EQUIPMENT, IN REAL TERMS, WILL DECLINE BY 1 1/2 PERCENT IN 1976 AND BY A FURTHER 2 1/2 PERCENT IN 1977.

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FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC PRIORITY 1980

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A LESS BYOYANT OUTLOOK FOR THE INTERNATIONAL ECONOMY, AND ESPECIALLY FOR THE UNITED STATES, IMPLIES THAT EXPORT GROWTH IN 1977 WILL BE LESS ROBUST THAN WAS ANTICIPATED IN THE EARLY FALL. GROWTH IN MERCHANDISE EXPORTS MEASURED IN REAL TERMS IS PROJECTED TO FALL TO ABOUT 4 PERCENT IN 1977 FOLLOWING A STRONG GRWOTH OF 11 PERCENT IN 1976. COINCIDENT WITH WEAKER EXPORT GROWTH WILL BE A DECLINE IN MERCHANDISE IMPORTS REFLECTING THE SLOWER PACE OF DOMESTIC ECONOMIC GROWTH AND IN PARTICULAR, THE DECLINE IN SPENDING ON CAPITAL GOODS. IN FACT, THE SOFTENING IN IMPORTS SHOULD BE SUFFICIENT TO RESULT IN AN OVERALL IMPROVEMENT IN THE MERCHANDISE TRADE BALANCE IN THE COMING YEAR. THE LOUTLOOK FOR THE SERVICE ACCOUNT OF THE BALANCE OF PAYMENTS, HOWEVER, IS LESS ENCOURAGING. THE CONTINUING UPWARD TREND IN THE DEFICIT ON TOURISM COMBINED WITH AN INCREASING DEFICIT ON INTEREST AND DIVIDEND PAYMENTS AS A RESULT OF HEAVY FOREIGN BORROWING AND THE RECENT DEVALUATION OF THE CANADIAN DOLLAR WILL LIKELY LEAD TO A SERVICE ACCOUNT DEFICIT MEASURED IN CURRENT DOLLARS OF \$6.9 BILLION IN 1977, UP \$1 BILLION FROM THE PREVIOUS YEAR. THE IMPROVEMENT IN THE MERCHANDISE ACCOUNT, HOWEVER, SHOULD MORE THAN OFFSET THE DETERIORATION IN THE SERVICE ACCOUNT AND AS A RESULT THE CURRENT ACCOUNT IS EXPECTED TO IMPROVE FROM A DEFICIT OF \$5 BILLION UNCLASSIFIED

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IN 1975 TO \$4.1 BILLION IN 1976. AND AGAIN TO \$3.9 BILLION IN 1977.

IN ADDITION TO THSE MAJOR FACTORS, SIGNS OF WEAKNESS HAVE EMERGED IN OTHER SECTORS OF THE ECONOMY. THE HOUSING SECTOR IS LIKELY TO BE MORE SLUGGISH THAN EARLIER APPEARED. TO DATE IN THE RECOVERY, REAL SPENDING ON RESIDENTIAL CONSTRUCTION HAS BEEN AN IMPORTANT POSITIVE ELEMENT. THESE EXPENDITURES ARE EXPECTED TO INCREASED BY ALMOST 19 PERCENT IN 1976. AN ACCUMULATION OF INVENTORIES OF FINISHED UNITS, HOWEVER, HAS LED TO A READJUSTMENT IN THIS MARKET WHICH HAS RESULTED IN DECLINES IN HOUSING STARTS IN EVERY QUARTER SINCE THE SOURTH QUARTER OF 1975. THIS PROCESS IS LIKELY TO CONTINUE UNTIL A TROUGH IS REACHED IN THE RANGE OF 220,000 UNITS ON AN ANNUAL BASIS TOWARDS MID-1977. FOR

1977 AS A WHOLE, A DECLINE OF 6 1/2 PERCENT IS PROJECTED FOR SPENDING ON RESIDENTIAL CONSTRUCTION.

FURTHERMORE, THE GOVERNMENT SECTOR ALSO NOW APPEARS TO BE WEAKER IN 1977. THAN PREVIOUSLY EXPECTED. ESTIMATES OF SPENDING AT ALL LEVELS OF GOVERNMENT ON REAL GOODS AND SERVICES INDICATE THAT FISCAL AUTHORITIES ARE MAKING A SERIOUS EFFORT TO CONTROL THE GROWTH OF GOVERNMENT SPENDING. IN THE THIRD QUARTER OF THIS YEAR TOTAL GOVERNMENT SPENDING ON REAL GOODS AND SERVICES WAS VIRTUALLY UNCHANGED FROM ITS LEVEL OF A YEAR EARLIER. IN LINE WITH THIS PERFORMANCE, THESE EXPENDITURES ARE EXPECTED TO INCREASE BY ONLY 3 1/2 PERCENT IN 1977. FOR THE TOTAL GOVERNMENT SECTOR, A DEFICIT OF \$4 BILLION, IN CURRENT DOLLARS, IS EXPECTED FOR 1976, RISING TO \$4.5 BILLION IN 1977.

IN A RELATIVE SENSE, EXPENDITURES ON CONSUMER GOODS HAVE BEEN AND WILL CONTINUE TO BE AN IMPORTANT SOURCE OF STRENGTH IN THE ECONOMY. SINCE THE BEGINNING OF THE UNCLASSIFIED

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ECONOMIC RECOVERY IN THE SECOND QUARTER OF 1975, TOTAL CONSUMER EXPENDITURES MEASURED IN REAL TERMS HAVE INCREASED AT AN AVERAGE ANNUAL RATE OF OVER 6 PERCENT. GIVEN THAT THESE EXPENDITURES ACCOUNT FOR ALMOST 65 PERCENT OF TOAL EXPENDITURES IN THE ECONOMY, IT IS CLEAR THAT THEY HAVE PLAYED AN IMPORTANT ROLE IN SUSTAINING THE RECOVERY DURING THIS PERIOD. WITH GROWTH IN INCOME FLOWS PROJECTED TO MODERATE IN 1977. IN RESPONSE TO A LOWER RATE OF INCREASE IN AVERAGE WEEKLY WAGES AND ONLY A MODERATE GAIN REALIZED IN EMPLOYMENT GROWTH, CONSUMER SPENDING SHOULD EXPAND BY LESS THAN 3 1/2 PERCENT COMPARED TO 6 PERCENT IN 1976. HOWEVER, GIVEN THAT FINAL DOMESTIC DEMAND IS FORECAST TO GROW BY ONLY 2 1/2 PERCENT, CONSUMER SPENDING REMAINS ONE OF THE RELATIVELY STRONG AREAS OF THE ECONOMY.

WEAKENING MARKET CONDITIONS COMBINED WITH THE EFFECTS OF THE PRICE AND WAGE CONTROL PROGRAM SHOULD RESULT IN A CONTINUATION OF THE TREND TOWARDS MODERATING INFLATION RATES. THIS WILL BE MOST EVIDENT IN THE BROADER MEASURES OF INFLATION. IN PARTICULAR, THE RATE OF INCREASE IN THE FINAL DEMAND DEFLATOR IS EXPECTED TO DECLINE FROM 9 1/2 PERCENT IN 1976 TO 7 1/2 PERCENT IN 1977. SIMILARLY, THE RATE OF INCREASE IN THE CONSUMER PRICE INDEX IS LIKELY TO DECLINE, ALTHOUGH MORE MODERATELY, TO APPROXIMATELY 7 1/4 PERCENT IN 1977 FROM A RATE OF ADVANCE OF APPROXIMATELY 7 3/4 PERCENT IN 1976.

IN AN ENVIRONMENT OF POOR INVESTMENT SPENDING, AN
IMPROVING PROFIT PERFORMANCE AND A MODERATE EXPANSION IN
CONSUMER SPENDING, THE DEMAND FOR SHORT-TERM FUNDS
SHOULD BE WEAK. AS A RESULT THE DECLINE IN SHORT-TERM
INTEREST RATES EXPERIENCED IN LATE 1976 SHOULD
CONTINUE WELL INTO 1977. LONGER TERM RATES WILL DECLINE AT
A MORE MODERATE PACE WITH THE AVERAGE YIELD ON
INDUSTRIAL BONDS PROJECTED TO DECLINE BY MORE THAN 30
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BASIS POINTS DURING THE YEAR.

IN SUMMARY, RECENT ECONOMIC DEVELOPMENTS HAVE LED TO
A SIGNIFICANT REVISION IN THE OUTLOOK FOR THE STRENGTH OF THE
CANADIAN ECONOMY IN 1977. GROWTH IN REAL OUTPUT IS
EXPECTED TO DECLINE TO 3 PERCENT IN THE COMING YEAR
RESULTING IN FURTHER INCREASES IN THE UNEMPLOYMENT RATE.
THE PROSPECTS FOR FURTHER DECLINES IN THE INFLATION
RATE AND IN INTEREST RATES ARE GOOD IN AN ENVIRONMENT
OF CONTINUING WEAK DEMAND IN MOST MARKETS.
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